



TAX EXEMPT AND
GOVERNMENT
ENTITIES DIVISION

**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Attn: Mandatory Review, MC 4920
1100 Commerce Street
Dallas, TX 75242**

Number: **200837044**
Release Date: 9/12/2008

UIL: 501.15-00

Date: June 2, 2008

LEGEND

ORG = Organization name XX = Date Address = address

**ORG
ADDRESS**

**Employer Identification Number:
Person to Contact / ID Number:
Contact Numbers:
Voice:
Fax:**

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

In a determination letter dated October 6, 20XX, you were held to be exempt from Federal income tax under section 501(c)(15) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(15) of the Code. Accordingly, your exemption from Federal income tax is revoked effective for years beginning January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(15) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On February 14, 20XX, you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(15) of the Code.

You have filed taxable returns on Form(s) 112-PC, for the year(s) ended December 31, 20XX & 20XX with us. For future periods, you are required to file Form 112-PC with the appropriate service center indicated in the instructions for the return.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals

process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free,

and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street

Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

January 9, 2008

LEGEND

ORG = Organization name

XX = Date

Address = address

ORG
ADDRESS

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Numbers:
Telephone:
Fax:

Dear :

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

We have also enclosed Publication 892, Exempt Organization Appeal Procedures for Unagreed Issues, and Publication 3498, *The Examination Process*. These publications include information on your rights as a taxpayer, including administrative appeal procedures within the Internal Revenue Service.

If you request a conference with Appeals, we will forward your written statement of protest to the Appeals Office, and they will contact you. For your convenience, an envelope is enclosed. If you and Appeals do not agree on some or all of the issues after your Appeals conference, the Appeals Office will advise you of its final decision

If you elect not to request Appeals consideration but instead accept our findings, please sign and return the enclosed Form 6018-A, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking your exempt status under I.R.C. § 501(c)(15). If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and send a final letter advising of our determination.

In either situation outlined in the paragraph above (execution of Form 6018-A or failure

to respond within 30 days), you are required to file federal income tax returns for the tax period(s) shown above, for all years still open under the statute of limitations, and for all later years. File the federal tax return for the tax period(s) shown above with this agent

within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance.

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018-A
Report of Examination
Envelope

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX 12/31/20XX

LEGEND

ORG = Organization name XX = Date City = city Country = country
 Founder = founder Founder Family = founder family EMP-1 & EMP-2 = 1st
 & 2nd employees CO-1 & CO-2 = 1st & 2nd companies

ISSUES

1. Does ORG. qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15), for the years ending December 31, 20XX & 20XX?
2. If ORG. does not qualify for tax exempt status for years ending December, 31, 20XX & 20XX, what are the tax consequences?
3. If the tax exempt status is revoked, how will it affect future years?

FACTS

ORG Limited (ORG) was formed in July 19XX, in City, Country, as a reinsurance company. Its purpose was to receive credit life and credit accident and health insurance premiums from CO-1 (CO-1) pursuant to an agreement that was executed in November 19XX. Founder was the sole shareholder. She did not own any controlling interest in any other company.

CO-1 provided insurance to customers of automobile CO-2s owned by the Founder Family. Customers would buy the insurance from CO-1 upon purchasing an automobile. CO-1 would then reinsure with ORG, sending a portion of the premiums collected to ORG. ORG would then become liable for some of the claims that would be filed.

Over the years, ORG made loans to CO-2 and family members. Interest was accrued and collected on these loans. Loans were outstanding during 20XX. Due to the variable financial status of CO-2, the interest accrued through 20XX was written off in 20XX, as a bad debt, and the principal was characterized as doubtful. CO-2 started repaying on the principal in 20XX. EMP-1 is to close out the loan by the end of 20XX. The loan issued to EMP-2 was closed out during 20XX.

Since 20XX, ORG has been in voluntary run-off. No new reinsurance agreements were executed, no premiums were accepted. The sole purpose of ORG since 20XX has been to pay claims on the risks that were ceded to ORG, reimburse customers if they cancelled their policies prior to expiration, and manage its investments, including collecting on the loans made.

ORG expects to file its Final Tax Return for tax year 20XX barring any unforeseen issues with resolving the remaining risk, and should the company successfully negotiate with one last customer to close out a contract that expires in January 20XX.

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Forms 990 were filed for the 20XX & 20XX tax years. The following is a breakdown of the Gross Receipts received by ORG for the years ending December 31, 20XX & 20XX, and the percentage of Gross Premiums to Gross Receipts for the same years per Notice 2006-42.

ORG	20XX	20XX
Total Premiums		
Interest Income		
Dividend Income		
Gain On Sale of Securities		
Total Gross Receipts		
Percentage- Gross Premium/Reinsurance Income to Gross Receipts		

LAW AND ANALYSIS

1. Does ORG. qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15) for the years ending December 31, 20XX & 20XX?

Internal Revenue Code section 501(c)(15)(A) exempts from Federal income tax insurance companies (as defined in section 816(a)) other than life (including interinsurers and reciprocal underwriters) if-

- (i.) (I) the gross receipts for the taxable year do not exceed \$600,000, and
(II) more than 50 percent of such gross receipts consist of premiums, or
- (ii.) in the case of a mutual insurance company-
(I) the gross receipts of which for the taxable year do not exceed \$150,000
and,
(II) more than 35 percent of such gross receipts consist of premiums.

Clause (ii) shall not apply to a company if any employee of the company, or a member of the employee's family (as defined in section 2032(A)(e)(2), is an employee of another company exempt from taxation by reason of this paragraph (or would be so exempt but for this sentence).

Sec. 206, Clarification of Exemption from Tax for Small Property and Casualty Insurance Companies, of the Pension Funding Equity Act of 2004, P.L. 108-218,

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amended section 501(c)(15)(A) to change the definition of small property and casualty insurance companies (insurance companies other than life insurance companies) exempt from income taxes to: (1) a company whose gross receipts for the taxable year do not exceed \$600,000, and over half such gross receipts consist of premiums (currently, whose net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed \$350,000); or (2) a mutual insurance company (a) whose gross receipts for the taxable year do not exceed \$150,000 and more than 35 percent of which consist of premiums and (b) none of whose employees (or member of the employee's family) is an employee of another company exempt from tax under section 501(c)(15). These changes were applicable after December 31, 20XX.

Notice 2006-42, IRB, 2006-19 provides guidance as to the meaning of "gross receipts" for purposes of section 501(c)(15)(A) of the Internal Revenue Code. This notice advises taxpayers that the Service will include amounts received from the following sources during the taxable year in "gross receipts" for purposes of § 501(c)(15)(A):

- A. Premiums (including deposits and assessments), without reduction for return premiums or premiums paid for reinsurance;
- B. Items described in § 834(b) (gross investment income of a non-life insurance company); and
- C. Other items that are properly included in the taxpayer's gross income under subchapter B of chapter 1, subtitle A, of the Code.

Thus, gross receipts include both tax-free interest and the gain (but not the entire amount realized) from the sale or exchange of capital assets, because those items are described in § 834(b). Gross receipts do not, however, include amounts other than premium income or gross investment income unless those amounts are otherwise included in gross income. Accordingly, the term gross receipts does not include contributions to capital excluded from gross income under § 118, or salvage or reinsurance recovered accounted for as offsets to losses incurred under § 832(b)(5)(A)(i).

Section 834(b)(1)(D) of the Internal Revenue Code includes under gross receipts the gains from the sale or exchanges of capital assets to the extent provided in subchapter P (section 1201 and following, relating to capital gains and losses).

Section 834(c)(6) of the Internal Revenue Code allows a deduction for Capital Losses to the extent provided in subchapter P (section 1201 and following) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

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Based on the changes in the limitations under Internal Revenue Code (IRC) Section 501(c)(15)(A), and the operation of ORG during 20XX & 20XX, it was determined from the chart above that ORG did not qualify for tax exempt status in 20XX and in 20XX. ORG was not able to meet the 50% requirement of Gross Premiums to Gross Receipts in either year (0.00% in 20XX & 0.00% in 20XX). Since ORG was not a mutual insurance company, the \$150,000/35% limitations were not applicable.

Section 206(e) of the Pension Funding Act of 2004, P.L. 118-218 provides the effective date of the new requirements for exemption under IRC 501(c)(15). It states:

EFFECTIVE DATE-

(1) **IN GENERAL-** Except as provided in paragraph (2), the amendments made by this section shall apply to **taxable years beginning after December 31, 20XX.**

(2) **TRANSITION RULE FOR COMPANIES IN RECEIVERSHIP OR LIQUIDATION-** In the case of a company or association which--

(A) for the taxable year which includes April 1, 20XX, meets the requirements of section 501(c)(15)(A) of the Internal Revenue Code of 1986, as in effect for the last taxable year beginning before January 1, 20XX, and

(B) on April 1, 20XX, is in a receivership, liquidation, or similar proceeding under the supervision of a State court, the amendments made by this section shall apply to taxable years beginning after the earlier of the date such proceeding ends or December 31, 20XX.

ORG was not involved in a court ordered liquidation during 20XX. The liquidation of RAR has been voluntary. Therefore, Section 206(e)(2) does not apply to this organization.

Therefore, for the years ending December 31, 20XX & 20XX, ORG did not qualify for tax exempt status under IRC 501(c)(15).

2. If ORG. does not qualify for tax exempt status for years ending December, 31, 20XX & 20XX, what are the tax consequences?

Since ORG did not qualify for tax exempt status under IRC Section 501(c)(15) for the 20XX and 20XX, ORG's filings of the Form 990 for both years was incorrect. For both years, ORG should have filed Form 1120-PC.

IRC 831 discusses tax on insurance companies other than life insurance companies.

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IRC 831(a) states as a general rule, "Taxes computed as provided in section 11 shall be imposed for each taxable year on the taxable income of every insurance company other than a life insurance company."

IRC 831(b) provides an alternative tax for certain small companies. It states in IRC 831(b)(1) that, in general, "In lieu of the tax otherwise applicable under subsection (a), there is hereby imposed for each taxable year on the income of every insurance company to which this subsection applies a tax computed by multiplying the taxable investment income of such company for such taxable year by the rates provided in section 11(b)."

IRC 831(b)(2) discusses the companies to which this subsection applies.

- (A) In general. This subsection shall apply to every insurance company other than life (including interinsurers and reciprocal underwriters) if-
- (i) the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed \$1,200,000, and
 - (ii) such company elects the application of this subsection for such taxable year.

The election under clause (ii) shall apply to the taxable year for which made and for all subsequent taxable years for which the requirements of clause (1) are met. Such election, once made, may be revoked only with the consent of the Secretary.

Regulations (Regs.) 301.9100-8(a)(2) discusses the time for making elections. Under (i) it states in general that except as otherwise provided in this section, the elections described in paragraph (a)(1) of this section, must be made by the later of-

- (A) The due date (taking into account any extensions of time to file obtained by the taxpayer) of the tax return for the first taxable year for which the election is effective, or
- (B) January 22, 1990 (in which case the election generally must be made by amended return)

Regs. 301.9100-8(a)(1) mentioned above includes IRC 831(b)(2)(A).

Regs. 301.9100-8(a)(3) describes the manner of making elections. It states, " Except otherwise provided in this section, the elections described in paragraph (a)(1) of this section must be made by attaching a statement to the tax return for the first taxable year for which the election is to be effective."

When ORG filed its Form 990 for years ending December 31, 20XX & 20XX, they attached to each return a "Protective Election". Each protective election stated that

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ORG elects to be subject to tax only on its taxable investment income as computed under IRC 834. The election is made pursuant to IRC 831(b)(2). It applies to the taxable year of the return and all subsequent taxable years that the election requirements are met. The Election was filed in the event it is determined that its tax exempt status under IRC 501(c)(15) is not upheld.

Based on the Code and Regulation sections above, and the "Protective Election" filed by ORG with each return, ORG is entitled to the relief under 831(b), for 20XX & 20XX, and all future years, because it met the requirements of Regs 301.9100-8(a)(2). ORG would be required to file Form 1120-PC for years ending December 31, 20XX & 20XX, and all future years that they do not qualify for exemption. The Election is allowed for these years and all future year when applicable.

3. If the tax exempt status is revoked, how will it affect future years?

The tax exempt status is being revoked for the year ending December 31, 20XX & 20XX. Form 1120-PC is required for each year and all future years where ORG does not qualify for exemption. The election filed is applicable for each year ORG is required to file Form 1120-PC. If ORG meets the requirements under IRC 501(c)(15) in future years, it may be allowed to file the Form 990 for each year they qualify, as a self-declared entity. Otherwise, Form 1120-PC would be required. Filing a Form 990 for a year where ORG qualifies for exemption under IRC 501(c)(15) does not stop the election made under IRC 831(b)(2). Any year where the Form 1120-PC is required, the election is applicable.

TAXPAYER'S POSITION

Unknown at the time of this writing

SUMMARY

It is the Governments position, based on the above facts, law and analysis, that the tax exemption status of ORG for the years ending December 31, 20XX & 20XX should be revoked based on not meeting the qualifications for exemption under IRC 501(c)(15). Form 1120-PC would be required to be filed for both years, and any future years where ORG does not qualify for exemption under IRC 501(c)(15). Relief under IRC 831(b) would be applied to each and every year the Form 1120-PC is filed.